

Reflections On Gold

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In line with the view I have been promoting on Business Monitor Online, spot gold has continued to push higher in recent trading to hit a new high of US\$1,095/oz at one point on Wednesday. I see potential for gold to head even higher in the short term as US dollar weakness, weaker equities, and investor appetite for hard assets buoy gold. In the event of a retracement, support now comes in around the US\$1,070/oz area.



Gold Prices, US/oz

Furthermore, I highlight several important themes that can be derived from higher gold prices: First, sustained equity weakness in recent trading, combined with higher gold prices, suggest that many investors are still risk averse. This is highlighted by a continued rise in net speculative positions in gold, as well as large inflows into gold Exchange-Traded Funds (ETFs). In addition, gold has been supported by purchases from emerging market central banks. The Reserve Bank of India (RBI) on Wednesday made the single largest purchase (US\$6.7bn) of the commodity by a central bank in the past 30 years. Meanwhile, China has hinted that it will continue to increase its holdings of gold in order to diversify its portfolio of assets. Second, gold is likely to continue outperforming equities. My colleagues and I have been arguing that the Dow-Gold ratio will continue to head lower. From a technical perspective, the ratio failed to break above trendline resistance at 9.5x, and moved to a level of 8.9x at one point on Wednesday. This implies that spot gold has been outperforming the Dow Jones, and could continue to do so.



Dow-Gold Ratio

Third, gold looks strong in several currencies. The technical charts of gold look particularly good in terms of EUR, NZD, GBP and INR. In terms of EUR, I would target a move back to the all-time high of EUR785/oz from the current level of EUR739/oz. Gold has made a new high in INR (Indian rupee) terms, in what looks like a very positive technical move. Indeed, gold broke above the previous all-time high INR49,787/oz to trade at INR51,355/oz at one point on Wednesday. What is particularly interesting is that India is the single largest consumer of gold for jewellery purposes and I believe that record prices will thus dampen Indian jewellery demand.



Gold Prices, INR/oz

Over the longer term, it is still hard to gauge the direction of gold prices, but I see them peaking

over the next few quarters. Indeed, higher prices will lead to an increase in both mine supply and the recycling of scrap gold, while at the same time reducing the demand for personal and industrial use. The wild card however, is investment demand, which has held up very well in recent months, and if this trend persists, it would negate this view.